

review⁵⁶ of the economic evidence presented on the record during 1992 appears to SWBT to have been taken somewhat out of context in MCI's 1992 opposition, has provided no evidence in the current investigation to suggest that sound financial theory would support MCI's current contentions.

MCI uses a single piece of the puzzle to attempt to fit its incorrect predetermined result without considering that the other sides of this piece do not match with any other pieces of the puzzle. MCI cannot be allowed to focus on alleged stock price reductions alone without considering the causative alleged reduction in earnings expectations that MCI claimed gave rise to the alleged stock price reductions in the first place.

Further, MCI states that "SWBT offers no empirical evidence which refutes the Warshawsky study showing that stock valuations did indeed fall prior to SFAS-106."⁵⁷ As SWBT explained above, however, one need not refute the Mittelstaedt/Warshawsky study or the contrary Ad Hoc claim to refute MCI's and Ad Hoc's incorrect claims. Whether or not there is any merit in the Mittelstaedt/Warshawsky analysis, there is no merit in MCI's use of the Mittelstaedt/Warshawsky study results.

Interestingly, Ad Hoc appears to disagree with the Mittelstaedt/Warshawsky results. Ad Hoc states that "the impact of the SFAS-106 rule on reported profits (for 1992) was large in an accounting sense, but was not reflected in stock price

⁵⁶ MCI Opposition, CC Docket No. 92-101, filed July 1, 1992, Drazen, pp. 2-3.

⁵⁷ MCI, pp. 19-20.

movements."⁵⁸ Regardless of the efficacy of Ad Hoc's differing allegation, there is no merit to Ad Hoc's use of its contention regarding no effect on stock prices. The correctness of Ad Hoc's premise does not prove its conclusion. Even if Ad Hoc's contention is true that "the LECs' rate of return prescriptions would already include reasonable investor perceptions of the effects of the adoption of SFAS-106,"⁵⁹ Ad Hoc provides no logic as to how double counting in the Commission's ROR prescription would result.

Thus, irrespective of investors' expectations regarding rate recovery of OPEB costs, neither MCI nor Ad Hoc have demonstrated the Commission's ROR prescription to have been fundamentally altered.

The simple fact that the Commission utilized the same ROR prescription for both price cap LECs and LECs under ROR regulation proves that the ROR prescription assumed exogenous treatment for price cap LECs.⁶⁰ ROR LECs receive rate recovery for the OPEB accounting change based on their cost of service showings. If the Commission presumed in 1990 that the price cap LECs would not receive exogenous treatment, and that investors had also made the same assessment, then it should have utilized different ROR prescription results for the two different groups of LECs. The Commission clearly did not do so. Therefore, the Commission presumed that rate recovery treatment of the OPEB accounting change would be the same for both ROR LECs and price cap LECs.

⁵⁸ Ad Hoc, fn. 16.

⁵⁹ Ad Hoc, fn. 16.

⁶⁰ U S WEST Direct Case, pp. 6-7.

NYNEX raises another important point which the opposition filings fail to rebut. It is a fundamental fact of the workings of financial markets, that diversifiable risk does not affect required return on investment. The risks of recovery of SFAS-106 costs that are perceived by investors are a diversifiable risk. This means that an investor wishing to avoid the financial risk associated with SFAS-106 can purchase shares of stock in companies with little or no SFAS-106 exposure. The ability of investors to avoid SFAS-106 exposure is clear based on the diversity of exposures by individual companies⁶¹ and the fact that only about 27% of the employees in the U.S. economy have retiree benefit plans that are subject to SFAS-106.⁶² The finance literature demonstrates that because this investment risk is diversifiable, investors do not require a higher return to compensate for it.⁶³ Thus, the ROR prescription was unaffected because investors did not require a higher return, regardless of their expectations regarding exogenous treatment.

C. Safeguards Offered by SWBT.

Even if notions of fairness and the satisfaction of all reasonable burdens of proof by the price cap LECs is not enough to

⁶¹ "FAS-106: Facing the Future," Goldman Sachs, June 1, 1992. "The Company-specific impact of FAS-106 varies widely between firms." This report presents data for approximately 85 companies that illustrates the SFAS-106 liability as a share of book value ranges from 0% to over 100%, with a significant number of companies in the 0-5% range.

⁶² See, e.g., Godwins study, p. 7.

⁶³ NYNEX Direct Case, Exhibit 1, p. 28, fn. 43, provides sufficient cites to the relevant finance theory.

earn exogenous treatment, the imposition of safeguards provides "belt and suspenders" safety for ratepayers.

The Commission's apparent lack of willingness to consider reasonable safeguards appears inconsistent with the magnitude of the SFAS-106 issue and its application of safeguards in other areas.⁶⁴ The oppositions rely on the Commission's reluctance to consider safeguards in their dismissals of SWBT's efforts to establish a sufficient level of trust on the issue.⁶⁵ Contrary to Ad Hoc's allegations,⁶⁶ SWBT's sincere effort at providing safeguards is not an admission that "intertemporal" double counting exists. SWBT is willing to provide the Commission with the tools necessary to demonstrate that the level of future SFAS-106 expenses will not fall below the levels used to determine exogenous amounts.

SWBT recognizes that the Commission may have concerns related to a suspicion of the actuarial process. Vague, unsubstantiated suspicions are difficult to dispel. SWBT's actuarial valuation, however, has been scrutinized and found sound for ratemaking purposes.⁶⁷

⁶⁴ Examples of these safeguards include: cost accounting requirements, custom proprietary network information (CPNI); network disclosure; installation and maintenance nondiscrimination reports.

⁶⁵ Ad Hoc, p. 7; Allnet, p. 5. Also, AT&T, pp. 16-17, which relies on its flawed example in Appendix B-2.

⁶⁶ Ad Hoc, p. 7. SWBT firmly believes that intertemporal double counting would not exist. SWBT does acknowledge the need for a negative exogenous adjustment when the TRO amortization expires.

⁶⁷ SWBT's valuation has already undergone significant specific scrutiny. For example, Texas has accepted SFAS-106, and SWBT's valuation of it, for ratemaking purposes.

SWBT's actuarial study took into consideration all of the beneficial effects SWBT has realized from its aggressive management of its health care expenses by reducing the base dollars, including the effect of the cap on retiree expenses which has the effect of making OPEB expenses relatively flat and very predictable going well into the future. Additionally, the key assumptions used in the study compare favorably with assumptions used by unregulated Fortune 500 companies which have no incentive, real or perceived, to inflate their OPEB liabilities.

The FASB recognized that actual experience could differ over time when compared to actuarial expectations. To ensure that material discrepancies, if any, would not impair the validity of financial statements, the FASB requires an annual true-up to track such changes and ensure that they are folded into expense calculations. SFAS-106 allows the recognition of such gains and losses immediately or on a deferred basis. The deferral method takes into account that gains in one period may be offset by a loss in a subsequent period, and therefore recognizes differences between actual experience over expected in a way that avoids potentially large swings in expense levels from year to year.

Some state commissions have found comfort in the stabilizing effect of the deferral approach, whereas others have expressed concern that a long-term amortization may prevent customers from realizing the benefits of actuarial gains in a timely manner. SFAS-106 is not a package deal dictated by "the accounting powers that be" to be followed by regulators. Although it sets forth standards by which all companies must abide for financial reporting purposes, regulators in many of the 38 state

jurisdictions that have adopted SFAS-106 have required their own safeguards to ensure that the new method of accounting for OPEBs made sound ratemaking policy in their individual states.

These safeguards have taken various forms.⁶⁸ SWBT had previously opposed funding as a necessary condition of exogenous treatment.⁶⁹ At this point, however, SWBT is willing to accept a funding requirement as an additional safeguard, if the Commission deems it necessary.⁷⁰ In March 1993, SWBT fully funded its incremental SFAS-106 expense in the three intrastate jurisdictions where rate recovery was allowed and funding was required.

Thus, the Commission should not be entirely reluctant to adopt safeguards, assuming, arguendo, fairness and the record have not satisfied the Commission alone. SWBT encourages the Commission to satisfy its concerns through the various ratemaking safeguards which are available, including the offers made by SWBT,⁷¹ rather than a wholesale rejection of exogenous treatment of SFAS-106.

The issue of safeguards is finally an issue of trust. The Commission can be assured that SWBT's offer to abide by appropriate safeguards is aimed at retaining a trust that SWBT is not attempting to game the regulatory process.

⁶⁸ Many states have required funding. Rhode Island recently required standard actuarial assumptions. New York adopted a ten-year deferral period (rather than the average remaining service life) for the recognition of gains and losses.

⁶⁹ SWBT Rebuttal, CC Docket 92-101, filed July 31, 1992, pp. 11-13.

⁷⁰ This is an issue of equity. Funding prior to implementation of price cap regulation has been effectively used by a significant number of price cap LECs.

⁷¹ SWBT Direct Case, pp. 22-23, 25, Appendix G; SWBT Rebuttal, CC Docket No. 92-101, p. 45.

II. UNDER THE EXISTING RULES, THE RATE ELEMENTS ASSOCIATED WITH LIDB SHOULD REMAIN IN THE TRANSPORT CATEGORY.

Ad Hoc claims that LIDB belongs in the local switching category.⁷² Allnet asserts that the record of the Transport proceeding is replete of LEC statements that Transport is overloaded with costs which do not belong there and that the LIDB makes logical decisions concerning call routing and provides information necessary to call delivery.⁷³ AT&T argues that a new service category should be established for the LIDB query charges.⁷⁴

SWBT agrees that Transport contains costs which do not belong in that category. Nevertheless, rate elements should not arbitrarily be moved for this reason alone.

Allnet's contention that LIDB provides call routing information and information necessary for call delivery is incorrect. LIDB validates billing information. Upon receipt of the LIDB response the carrier's network decides where to switch the call next and the transport facility that will carry the call to its destination. The fact that the query is associated with a call does not justify placing LIDB in the local switching category.

SWBT has consistently argued that, based on the Commission's existing Rules, Local Transport is the appropriate category for LIDB. Under Part 36 of the Commission's Rules, SWBT's Service Control Points (SCPs) are assigned to Central Office Equipment (COE) category 2 (transport), as are the Signaling

⁷² Ad Hoc, p. 25.

⁷³ Allnet, pp. 9-10.

⁷⁴ AT&T, page 37.

Transfer Points (STPs). These are the two primary costs underlying the LIDB Validation Query and LIDB Transport Query Charge. Thus, in matching the rate elements to the underlying costs, SWBT logically concluded that Local Transport is the appropriate category.

AT&T argues that "Inclusion of LIDB query charges within either the transport or switching service categories could result in unreasonable and unjustifiable pricing of LIDB relative to other elements within those categories."⁷⁵ In CC Docket No. 87-313, the Commission stated that it "determined that banding by service category, rather than by rate element, would best service the public interest."⁷⁶ This point is also made in the AT&T portion of the Order where the Commission "tentatively concluded that it would best serve the public interest to band LEC rates by service category, rather than by rate element."⁷⁷

AT&T appears to be arguing for a new service category that would contain one or two rate elements so as to produce the effect of rate element banding. This approach is completely counter to the philosophy behind price caps. The Commission has clearly rejected rate element banding as not serving the public interest.

SWBT put LIDB in Local Transport based on its associated costs and how the Commission's Rules categorize those costs. The

⁷⁵ AT&T, p. 38. (emphasis added).

⁷⁶ Policy and Rules Concerning Rates for Dominant Carriers, 4 F.C.C. Rcd. 2873 (1989) (Order) at paragraph 415.

⁷⁷ Order, para. 766.

Commission supported this conclusion in the SWBT LIDB Order.⁷⁸ The Commission should reject any argument that essentially calls for rate element banding.

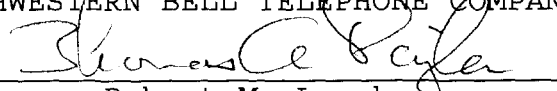
III. CONCLUSION.

For the foregoing reasons, SWBT respectfully requests that the Bureau find that SWBT has borne its burden of demonstrating that implementing SFAS-106 results in an exogenous cost change for the TBO amounts, and that SWBT has properly placed LIDB query charges in the Transport category.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY

By



Robert M. Lynch
Richard C. Hartgrove
Thomas A. Pajda

Attorneys for
Southwestern Bell Telephone Company

One Bell Center, Suite 3520
St. Louis, Missouri 63101
(314) 235-2507

September 10, 1993

⁷⁸ Southwestern Bell Telephone Company, Petitions for Waiver of Part 69 of the Commission's Rules, 6 F.C.C. Rcd. 6095 (Com. Car. Bur. 1991) (SWBT LIDB Order).

47 CFR Ch. I (10-1-92 Edition) Federal Communications Commission

§ 65.303 Cost of common stock equity.

(a) *General.* The cost of each issue of common stock (K_e) is to be calculated by the general formula: $K_e = D / (P + G_1)$; where D is the average annual dividend during the two calendar years preceding the represcription filing, P is the average daily price of that issue of common stock during each trading day during the two calendar years that precede the represcription

← stock price

filing, and G_1 is the annual rate of growth as hereinafter defined ($G_1 = G_1, G_2$). The calculations of the cost of common stock equity should consistently adjust D, P, and G, for stock splits and dividends of shares of common stock.

(b) *Calculation of dividend ("D").* D is the average of the annual dividends that have been paid during the two calendar years that precede the represcription filing.

(c) *Calculation of common share price ("P").* P is the simple average of the New York Stock Exchange daily high and low prices during each trading day during the two calendar years that precede the represcription filing.

(d) *Calculation of growth ("G").* G_1 is the annual rate of growth in dividends derived from the slope of the ordinary least squares linear trend line of quarterly dividends that were declared during the two calendar years that precede the represcription period. G_2 is the simple average of the IBES median analysis' five year annual growth rate estimates of earnings during the two calendar years that precede the represcription filing. Thus, for each issue of common stock, two estimates of the cost of common stock equity are to be calculated:

← earnings expectations

(1) $K_{e1} = D / (P + G_1)$; (2) $K_{e2} = D / (P + G_2)$.

← formula

[51 FR 1808, Jan. 15, 1986, as amended at 51 FR 4599, Feb. 6, 1986]

CERTIFICATE OF SERVICE

I, Katie M. Turner, hereby certify that the foregoing "Rebuttal of Southwestern Bell Telephone In the Matter of 1993 Annual Access Tariff Filings" in Docket No. 93-193 has been filed this 10th day of September 1993.

A handwritten signature in cursive script, reading "Katie M. Turner", written over a horizontal line.

Katie M. Turner

September 10, 1993

Ad Hoc Telecommunications
James S. Blaszak
Gardner, Carton & Douglas
1301 K Street, N.W.
Suite 900, East Tower
Washington, D.C. 20005

Allnet Communications Services, inc.
J. Scott Nicholls
Manager of Regulatory Affairs
1990 M Street, NW, Suite 500
Washington, D.C. 20036

American Telephone & Telegraph Co.
Francine J. Berry, Judy Sello
Robert J. McKee, Peter H. Jacoby
295 North Maple Avenue
Room 3244J1
Basking Ridge, NJ 07920

Ameritech
John Litchfield
2000 W. Ameritech Center Dr.
Room 4H88
Hoffman Estates, IL 60196

Anchorage Telephone Utility
1201 Pennsylvania Ave., N.W.
Washington, D.C. 20004

Bell Atlantic
1710 H Street, N.W.
Washington, D.C. 20006

BellSouth
M. Robert Sutherland
4300 Southern Bell Center
675 W. Peachtree Street, N.E.
Atlanta, GA 30375

Centel
1050 Connecticut Ave., N.W.
Washington, D.C. 20036-5339

GTE Corporation
P.O. Box 152092
Irving, TX 75015-2092

GTE Corporation
1850 M Street, N.W.
Suite 1200
Washington, D.C. 20036

William Page Montgomery
Jenny H. Yan
Ecomonics & Technology, Inc.
One Washington Mall
Boston, MA 02018

Intnl. Communications Assoc. (ICA)
Brian R. Moir
1255 Twenty-Third Street, N.W.
Suite 800
Washington, D.C. 20037-1125

International Transcription Serv., Inc.
1919 M Street N.W.
Room 246
Washington, D.C. 20554

Lincoln Telephone Company
One Thomas Circle, Suite 800
Washington, D.C. 20005

MCI Telecommunications Corp.
Michael F. Hydock
Sr. Staff Member, Regulatory Analysis
Randy Klaus, Andrew Regitsky
1801 Pennsylvania Avenue, NW
Washington, D.C. 20006

MFS Communications Company, Inc.
Andrew D. Lipman
Jonathan E. Canis
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

MFS Communications Company, Inc.
Vice President-Govt. Affairs
Cindy Z. Schonhaut
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

NYNEX
120 Bloomingdale Road
White Plains, NY 10605

Pacific Bell & Nevada Bell
140 New Montgomery Street
Room 1522-A
San Francisco, CA 94105

Rochester Telephone Corporation
180 South Clinton Avenue
Rochester, NY 14646

Roseville Telephone Company
Paul J. Feldman
Fletcher Held & Hildreth
Attorney at Law
P.O. Box 33847
Washington, D.C. 20033-0847

Southern New England Telephone Co.
227 Church Street
New Haven, CT 06506

Sprint Communications Company
Leon M. Kestenbaum
Norina T. Moy
1850 M Street, N.W., Ste. 1110
Washington, D.C. 20036

Kathleen B. Levitz
Acting Chief Common Carrier Bureau
Room 500
1919 M Street, N.W.
Washington, D.C. 20554

Gregory Vogt, Chief
Tariff Division, Room 518
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

United Telephone Company
P.O. Box 11315
Kansas City, MO 64112

U S West Communications, Inc.
1020 19th Street, N.W.
Suite 700
Washington, D.C. 20036

Wiltel, Inc.
Its Attorneys
Bob F. McCoy
Joseph W. Miller
P.O. Box 2400, Ste. 3600
Tulsa, OK 74102

Wiltel, Inc.
Counsel
Eric Fishman, Sullivan & Worcester
1025 Connecticut Avenue, N.W.
Suite 1000
Washington, D.C. 20036